

Franchise Tax Board**ANALYSIS OF ORIGINAL BILL**

Author: Blumenfield Analyst: Angela Raygoza Bill Number: AB 529
Related Bills: See Legislative History Telephone: 845-7814 Introduced Date: February 25, 2009
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Golden State Scholarshare Savings Trust Contribution Deduction

SUMMARY

This bill would allow a deduction, as specified, for contributions made to the Golden State Scholarshare Savings Trust.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to provide financial incentive for taxpayers to invest in the Golden State Scholarshare Savings accounts.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately and specifically operative beginning on the first day of the first calendar quarter commencing more than 90 days after a source of funding is identified to offset the cost to the State in allowing the deduction under this bill.

POSITION

Pending.

ANALYSIS**FEDERAL/STATE LAW**

Existing federal and state laws allow individuals to deduct certain expenses, such as medical expenses, charitable contributions, interest, and taxes, as itemized deductions. Certain other expenses for the production of income and certain employee business expenses are considered miscellaneous itemized deductions and on the portion that exceeds 2% of adjusted gross income¹ (AGI) may be deducted. Also, itemized deductions may be further limited for high-income taxpayers.

¹ For purposes of state income tax law, AGI is defined by cross-reference to the Internal Revenue Code (IRC) as gross income, which includes all income from whatever source derived, adjusted for certain allowable amounts, including IRA contributions, alimony paid, moving expenses, and Keogh account contributions. .

Board Position:

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Department Director

Date

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Under federal law, Internal Revenue Code (IRC) section 529 provides tax-exempt status to “qualified tuition programs” (QTPs). QTPs are programs established and maintained by a state, an agency, or an eligible educational institution to purchase tuition credits or make cash contributions on behalf of designated beneficiaries. Contributions to a QTP on behalf of any beneficiary cannot be more than the amount necessary to provide for the qualified higher education expenses.

THIS BILL

Under the Personal Income Tax Law, beginning on an undetermined date, this bill would allow taxpayers a State income tax deduction equal to the amount contributed to a Golden State Scholarshare Savings Trust Account.

The maximum deduction that would be allowed is as follows:

- \$2,500--Individuals and married couples filing separately and,
- \$5,000--Married couples filing jointly, Heads of Households, and Surviving Spouses

This bill would require the deduction to be taken in the taxable year that the contribution is made.

In addition, this bill would only become operative contingent upon funding to be identified by the Legislature that would offset the costs to the State in allowing the deduction.

Because this bill fails to specify otherwise, this deduction would be considered a miscellaneous itemized deduction and allowed only to the extent that all miscellaneous deductions exceed 2% of AGI for State income tax.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

This bill specifies that the provisions of this bill would become operative on the first day of the first calendar quarter commencing more than 90 days after a source of funding that is identified to offset the cost to the state in allowing the deduction. The bill fails to specify how FTB would be notified when funding has been identified to offset the cost to the state to make the provision added by the bill operative. It is recommended the author amend the bill to clarify the operative date when taxpayers are allowed to use the deduction specified in this bill.

This bill indicates that a source of funding would be identified to offset costs. If there is no funding for the costs associated with this bill in future years, it is unclear whether or not the deduction would become inoperative. It is recommended the author amend the bill to clarify how the deduction would apply if funding is no longer provided.

LEGISLATIVE HISTORY

SB 30 (Speier, 2005/2006) would have allowed taxpayers to take a deduction for contributions made to a Golden State Scholarshare Trust Account. This bill failed passage out of the Senate Revenue and Taxation Committee.

AB 530 (Stats. 1997, Ch. 851) established the California Golden State Scholarshare program in conformity with the federal qualified state tuition criteria. It provided an exemption from state taxation and tax deferred treatment for earnings from the Scholarshare program.

OTHER STATES' INFORMATION

The states surveyed include *Florida*, *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, and *New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida does not have a personal income tax.

Illinois has the College Savings Pool program named "Bright Start." A deduction is allowed from an individual's AGI for contributions made to the College Savings Pool.

Massachusetts and *Minnesota* are aligned with federal treatment of QTPs under IRC section 529; contributions to a QTP are not deductible.

Michigan has the Michigan Education Savings Program and the Michigan Education Trust. A contribution to either one of these programs is exempt from personal income tax up to \$5,000 for an individual return, or \$10,000 for a joint return.

New York has the New York State College Savings Program in which an account owner may deduct contributions made to one or more family tuition plans from federal AGI in computing New York AGI.

FISCAL IMPACT

Implementation of this bill could require changes to existing tax forms and electronic applications, which could result in the current tax return expanding to three pages. If the forms increase to three pages, the department would incur costs of over \$2 million for revising the forms and instructions, printing, systems changes, processing, and storage.

POLICY CONCERN

This bill would provide a tax benefit for sole proprietorships, non-corporate partners of partnerships, limited partnerships, limited liability companies not electing to be taxed as corporations, limited liability partnerships, and real estate mortgage investment conduits under the Personal Income Tax Law that would not be provided to other business entities, such as corporations. Thus, this bill would provide differing treatment based solely on entity classification.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue impact:

Estimated Revenue Impact of AB 529 Golden State Scholarshare Savings Trust As Introduced February 25, 2009 Enactment Assumed After June 30, 2009 (\$ in Millions)		
2009-10	2010-11	2011-12
\$0	\$0	\$0

Because AB 529 proposes a new deduction, the bill itself would not result in a revenue loss. The deduction would not be operative until a period of days after a source of funding is identified to offset the revenue loss from the deduction.

If a funding source were identified before December 31, 2010, revenue losses would be estimated at approximately \$2.6 million, \$4.6 million, and \$7.4 million in 2010-11, 2011-12, and 2012-13. The discussion below addresses the revenue losses.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue impact of this bill would depend on the amount of the Golden State Scholarshare Savings Trust contributions deducted on income tax returns of qualified taxpayers and the marginal tax rates of taxpayers reporting such deductions. This estimate assumes that the deduction is allowed for contributions made on or after January 1, 2010.

According to the data from the Scholarshare Investment Board, the Golden State Scholarshare Savings Trust consists of 236,500 existing accounts with assets totaling \$2.7 billion. Approximately 20% of these accounts are in the distribution phase or are already fully distributed. It is estimated that approximately 189,200 accounts are active and receive contributions periodically (236,500 existing accounts x 80% active contribution accounts). During 2008, approximately \$180 million was contributed to these accounts.

Based on historical data from the Scholarshare Investment Board, it is estimated for the 2009 taxable year there would be approximately 204,200 accounts that would receive contributions. In addition, approximately 20,000 new accounts on average would be established each year. This would result in approximately 224,200 accounts (204,200 accounts established in 2009 + 20,000 new accounts each year) receiving contributions in taxable year 2010. Assuming an average contribution of \$1,250 per active account, contributions to the Golden State Scholarshare Trust would be approximately \$280 million (224,200 x \$1,250). Deductible contributions are estimated at approximately \$70 million (\$280 million x 25%). Of taxpayers who itemize deductions, roughly one-quarter would have sufficient miscellaneous deductions to exceed the 2% AGI floor.

In the initial year of the deduction, it is assumed that approximately 50% of contributions that could be deducted are actually deducted. Because this is a State miscellaneous itemized deduction, the \$70 million in deductible contributions would be reduced to approximately \$35 million (\$70 million deductible contributions x 50% taxpayers can deduct) to account for taxpayers entitled to the deduction but fail to report it. Contributions deducted on tax returns would increase each subsequent year due to the knowledge of the deduction and number of additional new accounts that would be established.

Applying a 6.25% average marginal tax rate to the amount of deductible contributions derives a taxable year loss of approximately \$2.2 million (\$35 million taxpayers allowed to deduct loss x 6.25% tax rate) for the 2010 taxable year. A 6.25% average marginal tax rate was determined by analyzing income distributions of individuals potentially contributing to the Golden State Scholarshare Trust. Taxable year estimates are converted to fiscal year cash-flow estimates above. For example, the 2010 -11 cash flow estimate of \$2.6 million consists of approximately \$2.2 million for the 2010 taxable year and approximately \$.4 million for the 2011 taxable year.

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